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Why The Auto-Owners V. Second Chance Ruling Is Unique

Law360, New York (April 24, 2013, 1:18 PM ET) -- Twenty states, including Minnesota, have valued policy statutes. In those states, the insurer must pay the insured property owner the full face value of the policy in the event of a total loss. In Auto-Owners Insurance Co. v. Second Chance Investments LLC, 827 N.W.2d 766 (Minn. 2013), the Minnesota Supreme Court addressed the question of whether an appraisal panel can determine whether an insured sustained a total loss.

The court answered that question in the negative, finding that the appraisal provision in Minnesota's statutory standard fire insurance policy does not provide parties the right to have an appraisal panel decide whether a claim involves a total loss.

Underlying Facts

Second Chance purchased real property in Minnesota and obtained fire insurance on that property from Auto-Owners. Consistent with Minnesota's standard fire insurance policy, the Auto-Owners policy provided for payment of the $2 million policy limit in the event of a total loss.

On Nov. 11, 2008, the property sustained extensive fire damage. Parts of the building were charred and burned, and other areas were completely destroyed. Second Chance filed a proof of loss with Auto-Owners, claiming that the building was a total loss and that it was entitled to payment of the policy limits.

Auto-Owners' building consultant concluded that the building's shell, exterior walls, roof and floor assembly were reusable but that the most economical option was to demolish and then rebuild the structure. Based on its consultant's findings, Auto-Owners denied that the loss was total and paid Second Chance the cost to restore the building, a sum less than the policy limits. Thereafter, Second Chance submitted a second proof of loss, which included a repair estimate in an amount that exceeded the policy limit.

Auto-Owners responded by demanding appraisal to resolve "the scope of the damage and the amount of the loss." But Second Chance claimed that appraisal was inappropriate because a total loss occurred.

Nonetheless, Second Chance agreed to proceed with appraisal, reserving its right to challenge the appraisal panel's right to determine whether there was a total loss.

Auto-Owners, however, notified Second Chance that it would not proceed with appraisal unless the appraisal panel could render a binding decision on the total loss issue. So instead, it filed a complaint in state court seeking a declaration that all issues be submitted to appraisal, including the determination as to whether the property suffered a total loss.

Auto-Owners moved to compel appraisal. The trial court denied Auto-Owners' motion to compel appraisal, concluding that there was no Minnesota case authority holding that a total loss was an issue for appraiser. Because it denied Auto-Owners' motion to compel appraisal, the trial court dismissed the Auto-Owners complaint.

The Minnesota Court of Appeals affirmed the trial court, concluding that a court, and not an appraisal panel, was the appropriate forum to determine whether the property suffered a total loss. Auto-Owners Insurance Co. v. Second Chance Investments LLC, 812 N.W.2d 194, 201 (Minn. Ct. App. 2012).

The Minnesota Supreme Court granted Auto-Owners' petition for review on the sole issue of whether a party to a fire insurance policy has a statutory right to have an appraisal panel determine whether the insured property suffered a total loss.

The Court's Rationale

Before starting its analysis, the Supreme Court observed, by way of background, that Minnesota Statute section 65A.01, Minnesota's standard fire policy, was enacted in 1895 and that it was considered a "valued policy" law. The standard fire policy requires the insurer to pay the insured the limit of insurance in the event of a total loss.

The court also noted that the standard for determining a total loss provided that "[a] building is not a total loss ... unless it has been so far destroyed by the fire that no substantial part or portion of it above ground remains in place capable of being safely utilized in restoring the building to the condition in which it was before the fire." Nw. Mut. Life Ins. Co. v. Rochester German Ins. Co., 88 N.W. 265, 267 (1901).

Next, the court turned to the language of the standard fire policy's appraisal provision:

In case the insured and this company, except in case of total loss on buildings, shall fail to agree as to the actual cash value or the amount of loss, then, on the written demand of either, shall select a competent and disinterested appraiser and notify the other of the appraiser selected within 20 days of such demand.

Minn. Stat. § 65A.01, subd. 3.

The court noted that the parties' central dispute was over the meaning of the language "except in case of total loss" in this provision. Auto-Owners argued that it meant that a party could demand appraisal unless the loss already had been determined to be total. In other words, when the parties dispute

whether the loss is total, that question can be submitted to appraisal.

Second Chance, on the other hand, claimed that neither party could demand appraisal when the parties dispute whether a loss is total.

In agreeing with Second Chance, the court found the statutory language to be plain and unambiguous. Noting that a prerequisite to appraisal is that a dispute must exist between the parties, the court found that Auto-Owners' argument, that a total loss is excluded from the appraisal provision only when a total loss already has been determined, failed on its face.

The court reasoned that if a total loss already has been determined, there could be no dispute between the parties that would trigger the appraisal provision because in the event of a total loss, the insurer must pay the limit of insurance. Therefore, the court found that Auto-Owners' interpretation of the language "except in case of total loss" improperly rendered it meaningless.

The court concluded that the language, "except in case of total loss," when read in context, could only mean that appraisal may not be employed when the dispute is about a total loss. Therefore, the court found that when parties dispute whether a loss is total, that dispute must be resolved in the trial court and not by appraisal.

Analysis

Minnesota joins a handful of other states that do not allow an appraisal panel to determine the total loss issue under a valued policy. See Franklin Fire Ins. Co. v. Brewer, 159 So. 545, 547 (Miss. 1935); Lee v. Hamilton Fire Ins. Co., 167 N.E. 426, 427 (N.Y. 1929); Penn. Fire Ins. Co. v. Drackett, 57 N.E. 962, 963 (Ohio 1900); Seyk v. Millers Nat'l Ins. Co., 41 N.W. 443, 445 (Wis. 1889).

But unlike the courts in those states, the Minnesota Supreme Court employed a unique rationale. Courts in other jurisdictions have relied on the principle that "the sole purpose of an appraisal is to determine the amount of damage." 15 Lee R. Russ & Thomas F. Segalla, "Couch on Insurance" 3d, § 210:42 at 210-46 (2005).

The court in Second Chance, however, based its holding on an interpretation of statutory language, specifically the language, "except in case of total loss," in the state's standard fire policy.

Minnesota is likely to remain unique because it is the only state that currently includes that language in its statutory standard fire policy. Indeed, of the 20 states that have valued policy statutes, only eight, including Minnesota, also have a statutory fire policy. See Fire Casualty & Surety: The Complete Property & Casualty Information Service, Misc. Prop. M.70-2 - M.70-2, M.125-1 - M.125-4 (2012).

And none of the other seven states include the "except in case of total loss" language in the statutory standard fire policy. See Cal. Ins. Code § 2071; Ga. Comp. R. & Regs. 120-2-19-.01; La. Rev. Stat. Ann. § 22:1311; Neb. Rev. Stat. § 44-501; N.H. Rev. Stat. § 407:22; N.D. Cent. Code § 26:1-39-06; W. Va. Code § 33-17-2.

Therefore, the Second Chance decision, while controlling in Minnesota, will not be persuasive precedent for courts in other valued policy states facing the issue of whether an appraisal panel has authority to determine whether the insured has sustained a total loss.

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